THE MONETARY DOCTRINES OF GUSTAV CASSEL

BY

GERTRUDE VALENTINA GRODSKI

B.S., University of Illinois, 1943
M.S., University of Illinois, 1944

AN ABSTRACT OF A THESIS

SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
FOR THE DEGREE OF DOCTOR OF PHILOSOPHY IN ECONOMICS
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THE MONETARY DOCTRINES OF GUSTAV CASSEL

Economics is considered by Professor Cassel as a quantitative, measurable science. "Only to those activities which are conducted under the condition that the possible satisfaction of wants is limited," he gives the name "economic". From this general proposition he builds up his "principle of scarcity", which is the center of Professor Cassel's concept of an "economic situation", the subject matter of social economy. The term *social* economy is used rather than the usual "political economy" or "economics". He states: "I call this work *The Theory of Social Economy.* The meaning of this is that I intend to treat the economic relations of a whole social body as far as possible irrespective of its extension, its organization, its laws of property, etc."[1] As to what constitutes an economic situation, Cassel's scope of problem is broad. Furthermore, he does not attempt to analyze any particular economy.

Professor Cassel has been responsible for many of the internal monetary policies of Sweden; however, his reputation has been primarily based upon his works on international monetary problems, which have attracted world-wide attention. In addition to his systematic treatises, which alone would have assured him a distinguished place among contributors to economic literature, he was noted for his many press articles, speeches, and pamphlets which reached and influenced a far wider audience than that restricted to the classroom and formal authorship. His life-long journalistic medium was the *Svenska Dagbladet*, a Swedish daily newspaper.

The League of Nations twice requested him to prepare reports on the currency problems of the world in the post-war period. He also helped prepare a report for the German Government in 1922 on the economic situation in Germany.

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[1]Gustav Cassel, *The Theory of Social Economy,* trans. Barron, (rev. ed.; New York: Harcourt Brace and Co., 1932), Preface.

In the summer of 1924 he was invited by the Institute of Bankers in London to speak on the necessary conditions for England's return to the gold standard. In 1928, he made a lecture tour of the United States; and the Bank Committee of the House of Representatives requested him to give his views on the stabilization of the monetary system. He was also a delegate at the world Economic Conference held in London in 1933; this was the last international monetary conference he attended.

On many occasions Professor Cassel was requested by the Riksbank of Sweden to give advice on the monetary problems, and he often represented the Swedish Government as a delegate at the various International Conferences in the inter-war period. Many of his pubilc statements were in reference to the gold standard and its defects. Although he spent many years fighting for the restoration of the gold standard, he later abandoned altogether this position. His views on monetary policy in the past twenty years varied with the steadily changing aspects of the monetary problem.

Professor Cassel has a statical theory of money. His theory of money is conceived as an integral part of his general economic theory. A unit of money as fixed and invariable is postulated in his exposition of the general economic theory. From this, he constructs a theory of money which is suited to this foundation of the general theory. His theory of money has been a consequence of the stand he took with regard to the theory of value which is stated in his first work, *Outlines of an Elementary Theory of Prices,* published in the *Tübinger Zeitschrift,* 1899. In the later development of his theory of money, Professor Cassel holds that it has not been arbitrary or a result of influences from other authors.[2] The essential foundations of his theory of money first appear in his book, *The Nature and Necessity of Interest,* 1903.

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[2]Gustav Cassel, *Fundamental Thoughts in Economics,* (New York: Harcourt, Brace and Co., 1925), pp. 61f.

The essential part of his monetary theory is that the value of money is determined by the scarcity of the means of payment valid in the given monetary system. A monetary unit in which we can reckon all prices is assumed, and prices reckoned in this unit are determined by our system of equations except for a multiplicative factor. This indeterminedness can be removed by fixing the unit in which prices are reckoned and this is the task of the theory of money. Thus, Cassel's "system" is a combination of his general equilibrium theory, in which relative prices are determined simultaneously, and the quantity theory of money, in which the general price-level depends on the volume of the means of payment.

In the hypothetical treatment of the determination of the value of money, the quantity theory of money is interpreted in terms of objective factors which determine the relative demand for money so that the price-level is determined by purely mechanical means. Professor Cassel finds that the quantity theory of money has its shortcomings, and especially that it is based on the qualifying statement "other things equal". Therefore, he finds it indispensable to treat empirically the entire theory of the value of money on the basis of facts systematically collected for this purpose.

The earliest well-known study made of the quantitative relationship between the gold supply and the price-level was that of Professor Cassel. All other subsequent inductive studies of the subject have been based on this method with some modifications. After estimating economic progress, at the rate of three per cent annually, and computing the growth of the world's total stock of gold at about the same rate, Professor Cassel concluded that stability of general prices depended on the maintenance of this relationship. This study led him to propose measures to economize on the gold supply in order to compensate for its growing scarcity. His argument that the probable gold shortage may lead to a fall in the world gold prices is based upon the idea that in order to maintain stable gold prices, the world's gold stocks must increase at the rate of three per cent per annum, which is the rate that

appeared to be necessary during the period 1850-1910. With the various forecasts of world gold production, Professor Cassel's thesis points to the serious danger in the near future, and hence emphasis is placed upon the importance of a rational treatment of central bank reserves.

Professor Cassel holds to the "classical" thesis in reference to the theory of interest, which is that the rate of interest is determined by the supply of and demand for savings. He continues to repeat this theory despite the fact that it has been logically invalidated.

Cassel's whole system is dependent upon the implied assumption that business enterprise is always striving to use the available capital of a community. This leads him to oppose outright the idea of "oversavings" and insufficiency of income to buy the product. There can be no "redundant" savings, for capital is fully employed, savings always become invested, and income is never unused. Furthermore, the assumption of full utilization of savings leads him to conclude that government borrowing to finance public works withdraws capital from private enterprise and therefore affects employment.

An exhaustion of investment opportunities cannot be conceived by Professor Cassel and he relies on the support of a linear trend extrapolation. Since past trends showed that wealth doubled every twenty-five years, he, therefore, concludes that investment opportunities will be as great in the future as they were in the nineteenth century. This thesis cannot be more verifiable than the belief that investment opportunities are tending toward rapid exhaustion. Thus, he concludes that savers have to supply funds to meet the doubling of wealth for the next twenty-five years. And every new amount saved will give rise to a corresponding investment, and the savings-investment equation is maintained solely by the rate of interest.

A general equilibrium system of simultaneous equations is envisaged by Professor Cassel in which all relative prices are determined and then the theory of money is introduced to

determine the absolute level of prices. However, the equilibrium equations cover illegitimate assumptions. The condition that supply equals demand includes the assumption of full employment, and hence Professor Cassel logically deduces from his system that there cannot be such a thing as a general theory of employment (or unemployment). Another assumption of full employment is implicitly assumed in the statement that "every new amount saved gives rise to a corresponding investment". This would mean that consumption would have to be decreased so that resources may be set free which would not otherwise be available for investment, and therefore resources so set free would be always used for investment.

Professor Cassel opposes the "Theory of Employment" as expounded by J. M. Keynes; however, he arrives at practically the same conclusions regarding monetary policy as those which follow the above mentioned theory. A practical guide for monetary policy according to Professor Cassel is that the propensities to hoard should be offset by the creation of new money and that full employment can be achieved by an appropriate monetary policy independent of the level of wages.

Professor Cassel advocates credit expansion primarily to maintain the stability of the price-level in the face of an otherwise declining trend. He holds a great deal of faith in the possibility of managing world prices by purely technical monetary means, particularly by manipulation of bank rates on the part of central banks. He vehemently opposes the view that nothing should be done with the monetary system, and yet at the same time he criticizes deficit financing on the part of Governments.

Since a discount policy has been capable of regulating the value of the monetary unit in order to maintain its level with gold in the case of the gold standard, he concludes that a proper discount policy must be capable of regulating the value of a free paper standard. Professor Cassel has always ardently advocated the stablization of a currency, with the prime purpose of keeping the price-level constant. He has

constantly expressed the opinion that banking policy alone on the monetary side is directly responsible for changes in the general price-level and that a central bank by properly adjusting the supply of means of payment may impart to the currency any value desired.

Professor Cassel was responsible for revising the purchasing power parity doctrine in the light of the events during World War I and the immediate post-war period. The doctrine was primarily expounded to explain the exchange demoralization in terms of the creation of artificial purchasing power during World War I. Previous to this time, variations in the rates of exchange were explained in terms of the balance of payments; however, the purchasing power parity doctrine does not replace the aforementioned explanation, but supplements it. He further, points out that the depreciation of the exchange was not a phenomenon independent of internal monetary conditions. In order to meet some criticisms leveled at it and to test the theory empirically, the doctrine was modified; and, therefore, Professor Cassel has been accused, and wrongly so, of having abandoned his earlier position.

His doctrine was of practical importance in that it emphasized one single thought: it corrected the view that all the movements of foreign exchanges could be attributed to disturbances of the balance of payments. The doctrine was presented in a very simplified approximation adapted primarily to explain a particular situation. It depended upon certain assumptions, and if these assumptions were not fulfilled, the actual rates of exchange might deviate more or less from those representing purchasing power parity. If the restricted validity of the theory, which had been admitted by its founder, had been recognized, much of the critical literature would never have been written. From the purchasing power parity doctrine, Professor Cassel concludes that theoretically it is not impossible to maintain a stable exchange level between curriencies on a paper basis, for it can be accomplished by influencing the internal price-level through the credit and monetary structure.

Professor Cassel is at his best on practical monetary policies. A summary of his views on monetary policy are expressed in his book, *The Downfall of the Gold Standard.* Although he advocated the restoration of the gold standard in the early 1920's for reasons of expediency, he was aware of the advantages of a managed currency. He thought that the gold standard might have functioned if the world had adopted his "common sense" recommendations on reparations, war debts, trade, and monetary policies. He acknowledges in his memoirs this error of judgment in assuming that common sense would prevail.

Professor Cassel was of the opinion that a return to the gold standard after World War I would be a step forward toward stabilization. "The basis for this would be a stabilization of the value of gold itself in relation to goods, and this would be achieved by suitable regulation of the gold demand of the central bank."[3] His discussion led to many questions concerning the achievement of this all-round stabilization. Professor Cassel excelled in exposing currency fallacies; however, the constructive parts of his works leave something to be desired.

The failure of the gold standard in the inter-war period is chiefly explained in terms of the rates of exchange, which did not correspond broadly to the internal purchasing power of the different countries, and the lack of reasonable freedom of international trade and of international capital movements. He arrived at the conclusion that there is no way to a permanent stabilization of the world's monetary system other than to make the supply of credit entirely independent of gold reserves of central banks. He points out that if we choose gold as our standard, we must recognize the fact that we have chosen an invariable gold parity as the criterion of stability

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[3]Gustav Cassel, *In the Service of Reason: An Economic Autobiography (I Förnuftets Tjänst: An Ekonomisk Sjalvbiografi)*, Stockholm: Natur och Kultur, 1941), Vol. I, p. 232.

of our monetary unit. Thus, the value of gold in terms of commodities is variable and therefore such variations may have harmful effects.

We may conclude that Professor Cassel places great emphasis on monetary factors in contrast to other elements that play a part in economic progress. His writings have played a more significant role in the political field than in the development of economic science.

VITA

Gertrude V. Grodski was born February 22, 1922, at Riverside, Illinois. Her elementary education was received at St. Mary's Catholic School, Riverside, Illinois. She was graduated from Morton High School, Cicero, Illinois, in 1939. She attended Morton Junior College, 1939-1941, and the University of Illinois, 1942-43, where she received honors from both institutions. She received a Bachelor of Science degree in Economics in the School of Commerce in 1943 and a Master of Science degree in Economics in 1944, from the University of Illinois. She held an Assistantship in Economics at the University of Illinois during the years, 1944-45 and 1946-47. In 1945-46, she was an Instructor at Louisiana State University.